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C O N F I D E N T I A L SECTION 01 OF 03 BAGHDAD 002169

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SUBJECT: SHAHRESTANI PUSHING FOR REFORM IN THE MINISTRY OF OIL

REF: BAGHDAD 1552

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Classified By: Economic Minister Counselor Tom Delare, for reasons 1.4 (b) and (d).

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IMPORT LIBERALIZATION

14. (C) Minister Shahristani announced that he was, that afternoon, presenting fuel import liberalization legislation for discussion and approval by the Council of Ministers. He seemed confident that the legislation would be accepted without a problem. He had already discussed it within the Cabinet and also had concluded that the political mood would be conducive to rapid parliamentary action. (Note: The draft made it through the cabinet with only 2 dissenting votes. End Note) Based on that confident reading of the political situation, he concluded that introduction of the liberalization measure did not need to be done by decree. Regardless of that relatively optimistic appraisal, Shahristani did not expect that a significant amount of imported product would be available to the domestic market through private importers until the end of the year. Shahristani explained that import licenses would be granted by the Ministry through the State Oil Marketing Organization (SOMO), currently the only entity permitted to import petroleum products. Potential importers would need to prove they possess adequate capital and means of transportation, as well as the ability to meet environmental and safety requirements. There would be no pricing regulations, so importers would compete in an open market.

REFINING CAPACITY

15. (C) The Minister expressed his goal of increasing production of refined product to a total of 1.05 million barrels per day (bpd) to meet domestic needs-a figure that includes expected demand growth. He described a medium-term refinery construction plan that should help the Government of Iraq (GOI) meet that goal within three to four years. This refinery plan will ensure that each of the five main regions in Iraq will have a refinery to provide for local needs-a

strategy that we believe is not as economically sound as it is politically savvy. Existing refineries, such as that at Daura, will receive new units as older ones are decommissioned. Ten small plants will also be decommissioned as new facilities in areas such as the Central Euphrates and Nasiriyah are built. Shahristani explained that these capital

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17. (C) Despite lower than projected production during the early part of 2006, Shahristani was confident that current production levels will ensure that Iraq meets—even slightly exceeds—IMF Standby-by Arrangement (SBA) expectations. He also confirmed that the GOI would implement SBA-required fuel price hikes for both March and June by June 30. He even said the planned price hikes would be higher than stipulated by the IMF. (Note: Price increases were actually implemented on June 19 for diesel, kerosene and LPG, with new fuel prices reported at: LPG: ID 1000 per 12 Kg cylinder; Diesel: ID 125 per liter; Kerosene: ID 75 per liter; Gasoline: ID 175 per liter for 80 octane, ID 250 per liter for 86-87 octane, and ID 350 per liter for 91 octane; and Residual Heavy Fuel Oil: ID 200,000 per metric ton. At a subsequent meeting, the Minister explained that a decision had been taken to not increase gasoline prices in tandem with non-gasoline fuels. Although our surveys have shown some stations already selling fuel at the higher rates, a general price increase is only expected sometime before the end of the month. End Note)

18. (C) The Minister bullishly cited a goal of increasing oil production to 4.3 million bpd by the end of his term in 2010, insisting that the figure was possible through exploitation of existing fields and facilities and with minimal help from outside partners. He expects production of 6.7 million bpd by 2012, for which, he admits, new fields will need to be developed. In order to explore and produce these fields, Shahristani acknowledged that hydrocarbon legislation and participation of international oil companies will be necessary. (Comment: Shahristani's goals are extremely optimistic, as many observers believe that considerable new development, infrastructure, and equipment will be necessary to meet even the stated 2010 target. With new fields taking 4-5 years to develop, and barring new fields coming on-line, IRMO estimates that 750 thousand additional bpd is a more realistic figure for increased production for a total of 3.15 mbpd vice 4.3 mbpd by 2010. End Comment).

PUSHING FOR IMPROVED CONTRACTING PROCEDURES

19. (C) The Minister admitted, "everyone knows there has been a lot of corruption in the Ministry of Oil." Recently, the Minister canceled about 20 fuel purchase contracts due to suspected corruption, including contracts for importing fuel from Kuwait because he was suspicious they "weren't clean." Shahristani said he plans to push at the Cabinet level for sending corruption cases to court. He also said he will remove people involved in corrupt contracting.

10. (C) Shahristani expressed his displeasure with American contractors KBR and Parsons, and their inability to complete the projects for which they have been retained. As an example, he noted that a Parsons contract to meter loading at the ABOT export terminal has been languishing for two years. He said KBR and Parsons keep making excuses for why work is not finished, and despite their appreciation for USG funding of these projects, the Iraqis would have preferred finding

alternate means of financing had they known how little oversight would be exercised over them. Shahristani made this same point to the Ambassador in his initial meeting as Minister with Emboffs on May 28 (reftel). When asked how the USG could mitigate the situation, he said we should hold our contractors accountable for performance delays since we are paying them. To emphasize his point, the Minister said he has fired employees in his Ministry due to corruption or

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COMMENT

¶13. Shahristani seemed confident in his new role, detailing actions he is pursuing in priority areas such as fuel import liberalization and fuel price increases, as well as improving oil production and refining. He also seemed serious about addressing corruption within the Ministry of Oil, though he appeared more focused on specific intelligence on corrupt Ministry personnel rather than the impact of sectoral reforms that would undermine financial incentives leading to corruption. Though he is supportive of fuel price and import reform, his appreciation for the importance of such measures seems more financially motivated (to meet IMF requirements or increase revenues). Shahristani was not nearly as specific in a way forward on passing hydrocarbon legislation as he was with achieving production and refining improvements. He gloss over of how the Ministry's internal committee will reconcile the multitude of model and draft laws is cause for some concern. The Minister was overly optimistic in his projections for increased oil production by the end of his term in office, casting some doubt on other declarations, such as his expectations for increased transparency within his Ministry. More generally, the tone of the meeting was encouraging considering initial misgivings about Shahristani's level of receptivity to U.S. involvement. He was timely, professional, and responsive--conducting the meeting like a Chief Executive Officer aware of the challenges facing his organization, but prepared with a strategy for addressing these challenges. He downplayed dependence on U.S. resources, asserting the ability of the Ministry to undertake proposed initiatives--except in the area of security.

KHALILZAD